No. 06-43

IN THE

# Supreme Court of the United States

STONERIDGE INVESTMENT PARTNERS, LLC,
*Petitioner,*

v.

SCIENTIFIC-ATLANTA, INC. AND MOTOROLA, INC.,
*Respondents.*

**On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit**

## BRIEF FOR THE NASDAQ STOCK MARKET, INC. AND NYSE EURONEXT AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

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TABLE OF CONTENTS


| | Page |
|---|---|
| TABLE OF AUTHORITIES | iii |
| INTERESTS OF *AMICI CURIAE* | 1 |
| SUMMARY OF ARGUMENT | 4 |
| ARGUMENT | 6 |
| I. CREATING NEW PRIVATE SECTION 10(b) LIABILITY FOR ENTITIES THAT DO BUSINESS WITH PUBLICLY TRADED COMPANIES WOULD RAISE THE COST OF LISTING ON U.S. EXCHANGES, WEAKENING THE GLOBAL COMPETITIVENESS OF THE NATION'S PUBLIC EQUITY CAPITAL MARKETS | 6 |
| A. Petitioner's Theory Would Impose Costly Audit or Insurance Obligations on Those Who Do Business with Publicly Traded Companies | 9 |
| B. Increasing the Cost of Doing Business with Publicly Traded U.S. Companies Encourages Flight to Foreign Equity Markets, Which Offer Increasingly Competitive Alternatives | 12 |
| II. CREATION OF ANY NEW PRIVATE SECTION 10(b) "PARTICIPANT" LIABILITY SHOULD BE LEFT TO CONGRESS | 15 |
| A. By Providing for Specific "Participant" Liability in Other Securities Laws But Not in Section 10(b), Congress Has Precluded Implied Section 10(b) Participant Liability | 16 |

TABLE OF CONTENTS—Continued

Page

B. Congress Is Better Suited than the Courts to Weigh the Costs and Benefits of Creating Section 10(b) "Participant" Liability ..... 18

C. Existing Regulatory Mechanisms Established and Enhanced Periodically By Congress Make Implication of Expansive Private "Participant" Liability under Section 10(b) Unnecessary ..... 19

CONCLUSION ..... 22

# TABLE OF AUTHORITIES


| CASES | Page |
|---|---|
| *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) | 11 |
| *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994) | 8, 15 |
| *Credit Suisse Sec. (USA) LLC v. Billing*, 127 S. Ct. 2383 (2007) | 15 |
| *Marine Bank v. Weaver*, 455 U.S. 551(1982) | 7 |
| *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71 (2006) | 11 |
| *Pinter v. Dahl*, 486 U.S. 622 (1988) | 15, 18 |
| *SEC v. Zandford*, 535 U.S. 813 (2002) | 18 |
| *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499 (2007) | 15 |
| *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1982) | 16 |
| **STATUTES AND LEGISLATIVE MATERIALS** | |
| 15 U.S.C. § 77k(a)(4) | 17 |
| 15 U.S.C. § 77b(a)(11) | 17 |
| 15 U.S.C. § 78f(b)(1)-(9) | 2, 20 |
| 15 U.S.C. § 78j(b) | 17 |
| 15 U.S.C. § 78c(a)(26) | 2 |
| 15 U.S.C. § 78i(e) | 17 |
| 15 U.S.C. § 78s(g) | 2, 20 |
| 15 U.S.C. § 78t(e) | 8 |
| 15 U.S.C. § 7246 | 19 |
| H.R. REP. NO. 73-1383 (1934) | 7 |
| H.R. DOC. NO. 1383, 73d Cong., 2d Sess. (1934) | 20 |
| S. REP. NO. 73-1455 (1934) | 20 |
| S. REP. NO. 104-98 (1995) | 8 |

TABLE OF AUTHORITIES—Continued

Page

*Aiding and Abetting Liability under the Federal Securities Laws: The Impact of the Supreme Court's Decision in Central Bank: Hearing Before Subcomm. on Securities of the Sen. Banking, Housing, and Urban Affairs Comm.*, 103rd Cong. (1994)..... 8

*Private Securities Litigation Revision: Hearing on H.R. 10 Before Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce*, 104th Cong. (1995)..... 8

MISCELLANEOUS

Douglas E. Abrams, *The Scope of Liability under Section 12 of the Securities Act of 1933: 'Participation' and Pertinent Legislative Materials*, 15 FORDHAM URB. L.J. 877 (1987).. 16, 17

Bernard S. Black & Ronald J. Gilson, *Venture Capital and the Structure of Capital Markets: Banks versus Stock Markets*, 47 J. FIN. ECON. 243 (1998)..... 6

MICHAEL R. BLOOMBERG & CHARLES E. SCHUMER, SUSTAINING NEW YORK'S AND THE U.S.' GLOBAL FINANCIAL SERVICES LEADERSHIP (2006), *available at* http://www.tinyurl.com/2fhyuf..... 14

COMMITTEE ON CAPITAL MARKETS REGULATION, INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION (2006), *available at* http://www. capmktsreg.org/research.html ... 7, 13, 14

Ross Levine & Sara Zervos, *Stock Markets, Banks and Economic Growth*, 88 AM. ECON. REV. 537 (1998)..... 6

TABLE OF AUTHORITIES—Continued

Page

U.S. SEC. EXCH. COMM'N, MARKET 2000: AN EXAMINATION OF CURRENT EQUITY MARKET DEVELOPMENTS, Division of Market Regulation, U.S. Securities and Exchange Commission (1994) ..... 21

U.S. SEC. EXCH. COMM'N, Report of Special Study of Securities Markets, H.R. DOC. NO. 88-95, 1st Sess. (1963) ..... 21

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## BRIEF FOR THE NASDAQ STOCK MARKET, INC. AND NYSE EURONEXT AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

## INTERESTS OF *AMICI CURIAE* [1]

The Nasdaq Stock Market, Inc., operates The NASDAQ Stock Market LLC (collectively "Nasdaq"), the largest electronic equity securities market in the United States, which lists more companies than any other U.S. market. Nasdaq is a leading provider of securities listing, trading, and information products and services. It is home to approximately 3,200

[1] The parties have consented to the filing of this brief and their letters of consent have been filed with the Clerk. In accordance with Rule 37.6, *Amici* state that this brief was not written in whole or in part by counsel for any party, and no persons other than *Amici* have made a monetary contribution to the preparation or submission of this brief.

listed companies, domestic and foreign, with a combined market capitalization of over $4.6 trillion. Its listed companies represent a diverse array of industries, including information technology, financial services, healthcare, consumer products and industrials. Nasdaq pioneered electronic equities trading more than thirty-five years ago, creating the most replicated market model among global exchanges.

NYSE Euronext, the world's largest exchange group, operates cash equities and derivatives exchanges in the United States and Europe. It is a global leader for listings, equities trading, derivatives, bonds and the distribution of market data. As of June 2007, the total market capitalization of NYSE Euronext's approximately 3,900 listed companies was $30.8 trillion. In the United States, NYSE Euronext operates the markets known as the New York Stock Exchange LLC, the world's largest cash equities exchange based on market capitalization, and NYSE Arca, the first open, all-electronic stock exchange in the United States (collectively, for purposes of this brief, "the NYSE"). For over 200 years, the NYSE has provided a reliable, orderly, and efficient marketplace for investors and traders to buy and sell securities. The NYSE also performs regulatory functions relating to its exchanges and their participants.

Nasdaq and the NYSE are registered with the U.S. Securities and Exchange Commission ("SEC") as national securities exchanges and self-regulatory organizations ("SROs") within the meaning of Section 3 of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(26). The Exchange Act both authorizes and requires SROs to promulgate and enforce rules governing their membership and the conduct of members, member organizations and their employees, 15 U.S.C. §§ 78f(b)(1)-(9), 78s(g), as well as "to remove impediments to and perfect the mechanism of a free and open market . . . and, in general, to protect investors and the public interest." 15 U.S.C. § 78f(b)(5).

SROs in the securities industry are an essential component of the regulatory scheme for providing fair and orderly markets and protecting investors. The Exchange Act imposes on SROs multiple regulatory and operational responsibilities, including day-to-day market and broker-dealer oversight, as well as compliance-monitoring and enforcement of listing standards for listed companies. Virtually all aspects of Nasdaq's and the NYSE's operations are subject to oversight by the SEC.

The rules enforced by Nasdaq and the NYSE as SROs, and those to which they are subject, are focused on safeguarding the integrity of the securities markets and protecting market participants and investors. Nasdaq and the NYSE believe that quality regulation enables them to better serve listed companies, market participants and investors in providing high quality cash equities markets, access to deep pools of liquidity, and fast and transparent trading data and execution. This in turn enables the corporate growth, entrepreneurship, and innovation that are the hallmarks of the U.S. capital markets.

Nasdaq and the NYSE are acutely aware that the globalization of world markets and an increasingly competitive global environment for equity capital are challenging the United States' historical dominance in capital markets. Companies worldwide, with newly viable alternative venues for listing, launching IPOs, investing, and doing business, have voiced concerns to Nasdaq and the NYSE regarding the litigation climate generally in the United States and the potential expansion of third-party liability.

Nasdaq and the NYSE share an interest in an application of the securities laws that is faithful to the limitations imposed by Congress and this Court's prior decisions. In particular, Nasdaq and the NYSE believe that current and potential issuers (whether located in the United States or abroad) must not be dissuaded or inhibited from utilizing the U.S. capital markets by unreasonable and unpredictable extensions of

securities fraud liability to third parties providing services to such issuers. Nasdaq and the NYSE believe that the boundaries of who might be held potentially liable under the antifraud provisions of the Securities Exchange Act of 1934 should be clear and unambiguous, and that interpretations of those provisions that risk unbounded expansion of potential liability inhibit growth of and access to the U.S. capital markets.

For the reasons discussed more fully in this brief, Nasdaq and the NYSE respectfully urge the Court to affirm the decision below.[2]

## SUMMARY OF ARGUMENT

The United States public equity markets have long offered the most liquid, most competitive and best regulated pools of equity capital in the world. Public listing of companies on U.S. stock exchanges, under the regulatory mechanisms created by U.S. securities law, has greatly benefited U.S. investors and contributed to U.S. economic growth. But the globalization of world markets and an increasingly competitive global environment for equity capital are challenging the United States' historical dominance in capital markets. Companies worldwide, with newly viable alternative venues for listing, are increasingly launching IPOs, investing, and doing business outside the United States.

In this environment, increasing the costs of doing business with U.S. public companies weakens the competitiveness of the U.S. public equity capital markets and thus harms U.S.

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[2] NYSE Euronext is one of several defendants in a pending purported class action litigation asserting securities and antitrust law violations, styled *Sea Carriers, LP I et al. v. NYSE Euronext et al.*, No. 07 Civ. 4658 (S.D.N.Y.) (filed June 1, 2007). Although that complaint does not relate to NYSE Euronext's role as an issuer, an affirmance of the Eighth Circuit's decision below could benefit NYSE Euronext and other defendants in that matter.

investors and the U.S. economy. Petitioner's novel theory would impose such costs by extending private Section 10(b) liability to manufacturers, vendors and suppliers who merely do business with a publicly traded company that later makes a misstatement or material omission to its investors. Such a novel theory of liability would make one company responsible for another company's accurate accounting and reporting, thus converting business counterparties effectively into auditors and insurers of compliance with the securities laws. Counterparties thus will either avoid doing business with publicly traded companies or charge them more for doing so.

This approach is highly inefficient, and the costs it imposes are likely to discourage companies from listing or remaining on U.S. public stock exchanges and encourage their relocation to increasingly competitive foreign markets. Thus, far from increasing enforcement of the U.S. securities laws, Petitioner's theory, if adopted, would have the perverse effect of shrinking the scope of their coverage.

Such increased costs and their attendant harms to U.S. public equity markets, U.S. investors and the U.S. economy are unnecessary. Congress has created and periodically enhances a complex and overlapping set of protections for investors in U.S. publicly traded companies that provides adequate protection without need for new, judicially fashioned private causes of action.

Congress knows well how to add aiding-and-abetting or participant liability to this enforcement mosaic, and has done so in several narrowly defined circumstances. But Congress has never enacted the expansive, unlimited participant liability sought by Petitioner, even when specifically urged to do so by the SEC and others. Against this legislative backdrop, judicial creation of such liability would be inappropriate. The complex weighing of any marginal gain in deterrence from such new private Section 10(b) liability against the costs to U.S. public companies, their counterparties, and the competi-

tiveness of the U.S. public equity capital markets is quintessentially a matter of policy that should be left, if at all, to Congress and not the courts.

## ARGUMENT

### I. CREATING NEW PRIVATE SECTION 10(b) LIABILITY FOR ENTITIES THAT DO BUSINESS WITH PUBLICLY TRADED COMPANIES WOULD RAISE THE COST OF LISTING ON U.S. EXCHANGES, WEAKENING THE GLOBAL COMPETITIVENESS OF THE NATION'S PUBLIC EQUITY CAPITAL MARKETS

The United States has long been recognized as having the world's largest, most liquid, and until recently, most competitive public equity capital markets. Both American and foreign corporations historically have turned to these markets as principal sources for raising and pricing capital. Strong public equity capital markets stimulate other sources of capital formation; the venture capital industry, for example, invests in start-up companies based on the prospect that the most successful of them may be taken public.[3] And the contribution of strong capital markets to overall economic growth is well documented.[4]

The historical success of the nation's public equity capital markets has depended greatly on a strong system of securities regulation and self-regulation. "Tough enforcement is essential for a strong securities market," and "[t]he United States has the toughest administrative enforcement of securities laws

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[3] *See* Bernard S. Black & Ronald J. Gilson, *Venture Capital and the Structure of Capital Markets: Banks versus Stock Markets*, 47 J. FIN. ECON. 243 (1998).

[4] *See* Ross Levine & Sara Zervos, *Stock Markets, Banks and Economic Growth*, 88 AM. ECON. REV. 537 (1998).

in the world."[5] The securities laws adopted by Congress in the wake of the market crash of 1929 represent a remarkable regulatory success story. The Securities Act of 1933 increased disclosure of the financial conditions of publicly traded corporations, making the public securities markets much more transparent. The Securities Exchange Act of 1934, and in particular, Section 10(b) of that Act, were aimed at preventing unfair conduct in the trading of public securities.

Section 10(b) was *not* aimed, however, at regulating the conduct of those who merely conduct commercial transactions with companies listed on public equity capital markets. To the contrary, the Exchange Act sought in a targeted way "to regulate the stock exchanges and the relationships of the investing public to corporations which invite public investment by listing on such exchanges." H.R. REP. NO. 73-1383, at 2 (1934). Congress aimed to prevent, for example, securities price manipulation by market actors such as brokers, dealers, syndicates, financial writers, and insiders. Nothing in the Exchange Act's enactment reflected a concern with regulating commercial transactions in which securities issuers engaged in the ordinary course of their businesses. As this Court has often reiterated, the securities laws are not a general code of corporate conduct. *See, e.g.*, *Marine Bank v. Weaver*, 455 U.S. 551, 556 (1982) ("Congress, in enacting the securities laws, did not intend to provide a broad federal remedy for all fraud.").

Disregarding this history and these principles, Petitioners seek here to establish a private right of action under Section 10(b) against those who do business with a publicly traded

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[5] COMMITTEE ON CAPITAL MARKETS REGULATION, INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION 71-72 (2006) ("INTERIM REPORT"), *available at* http://www.capmktsreg.org/research.html.

corporation that misrepresents the parties' transaction to its shareholders—even where the issuer's counterparty makes no misstatement itself, and violates no fiduciary duty to the public issuer or its investors. Such a theory has twice been definitively rejected—once by this Court in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), which held that a private plaintiff may not maintain an aiding and abetting action under Section 10(b), and once by Congress, which pointedly declined to create such private liability despite the SEC's express recommendation that it overturn *Central Bank* by doing so. Congress instead granted the SEC, and only the SEC, authority to prosecute aiding and abetting of Section 10(b) violations in Section 20(e), 15 U.S.C. § 78t(e), a provision added by the Private Securities Litigation Reform Act (PSLRA).[6] The theory of private liability sought here and correctly rejected by the decision below is a transparent end run around these considered decisions by two branches of government.

Among the many reasons to reject Petitioner's argument is the significant harm its novel private liability theory would cause to publicly traded companies. Public listing of companies on stock exchanges like Nasdaq and the NYSE has benefited the nation's economy by enabling a high volume of securities trading within a sophisticated legal structure that

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[6] After *Central Bank* was decided, the SEC and others called for legislation overturning the decision, and Congress held several hearings on the subject. *See Aiding and Abetting Liability under the Federal Securities Laws: The Impact of the Supreme Court's Decision in Central Bank: Hearing Before Subcomm. on Securities of the Sen. Banking, Housing, and Urban Affairs Comm.*, 103rd Cong. (1994); *Private Securities Litigation Revision: Hearing on H.R. 10 Before Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce*, 104th Cong. (1994). Congress, however, determined that "amending the 1934 Act to provide explicitly for private aiding and abetting liability actions under Section 10(b) would be contrary to [the PSLRA's] goal of reducing meritless securities litigation," S. REP. NO. 104-98, at 19 (1995).

protects investors and businesses alike through administrative enforcement by the SEC and self-regulation by the SROs. The benefit of listing on U.S. exchanges also includes the periodic and offering disclosure obligations established and reviewed by the SEC. Imposition of inefficient and inappropriate costs on publicly traded companies through adoption of Petitioner's theory would diminish these benefits by discouraging companies from listing or remaining on U.S. public stock exchanges.

Thus, ironically, Petitioner's purported effort to increase the private enforcement of the securities laws might well have the perverse effect of decreasing the volume of securities business subject to those laws as companies seek to raise capital through public listings abroad or private alternatives.

### A. Petitioner's Theory Would Impose Costly Audit or Insurance Obligations on Those Who Do Business with Publicly Traded Companies

As the complaint in this case illustrates, Petitioner's theory of implied participant liability under Section 10(b) would greatly increase the risk that accompanies doing business with companies traded on U.S. public stock exchanges. Petitioner, an investor in publicly traded securities issued by Charter Communications, does not allege that Motorola or Scientific-Atlanta made any misstatements or omissions upon which it relied in connection with the purchase or sale of those securities, nor that Motorola or Scientific-Atlanta owed Charter or its investors any fiduciary duty of disclosure. Petitioner does not allege that Motorola or Scientific-Atlanta improperly accounted for or misreported the supposedly "sham" transactions. Petitioner alleges only that it relied upon false statements by Charter concerning its financial performance, which Charter was able to report because of its previous commercial transactions with Motorola and Scientific-Atlanta.

Petitioner thus seeks to impose private liability on Respondents solely for another company's failure to account for and report their mutual commercial transactions properly. Such liability would add a burdensome obligation in addition to those already imposed by the securities laws. Under existing Section 10(b) rules, a public company may engage in a wide range of transactions with counterparties based solely on business considerations, so long as those transactions are properly accounted for and accurately reported by the company to the investing public. Under Petitioner's theory, however, counterparties would risk civil damages liability if they failed to ensure that the publicly traded company with whom they were doing business was also properly accounting for and accurately reporting those transactions. Such potential liability could lack any proportion to the business transaction at issue.

Faced with such potential liability, a commercial vendor or purchaser has three choices. *First*, it can increase its due diligence with respect to its commercial transactions with a publicly traded company in order to decrease its risk of exposure if that company later fraudulently accounts for those transactions. Implementing this due diligence would effectively transform a business relationship into an auditing relationship.

This approach is likely to be highly inefficient. By analogy, firms that are already subject to the reach of securities liability, such as underwriters for a newly offered company, engage in a significant, costly and time-consuming legal and financial due diligence review of the company, its management and its statements in the offering document. Even a pared-down version of this diligence review would take time, slowing the ability of public companies to sign contracts and making them less competitive with their private and foreign counterparts. On Petitioner's theory, a business transaction would not be complete when a contract is performed but

would require ongoing surveillance until the public company's quarterly or annual reports were filed. Such an approach would also undermine the division of labor within corporations. Sales employees, acting in a non-accounting role and without expertise in the preparation or issuance of financial statements, could subject their companies to litigation risk merely by engaging in a business transaction that was later improperly accounted for or reported by the financial employees of a public company with whom they did business—employees wholly uninvolved in the underlying sales transaction.

*Second*, a commercial vendor or purchaser that does business with publicly traded companies can insure against the risk that those companies will fraudulently report transactions. It can do so by increasing formal insurance coverage. Or it can self-insure by charging higher prices to do business with publicly traded companies.

The cost of such insurance or self-insurance could well be significant given the litigation features of Petitioner's theory. This Court has acknowledged in general "that 'litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general.'" *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 80 (2006) (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739 (1975)). The risk of vexatiousness is likely to be especially high on the theory urged here. "Participation" with a supposed "purpose and effect" to advance a fraud is easy to allege and difficult to dismiss without factual development, increasing incentives to settle even the most baseless or attenuated participation claims. Moreover, awards risk being dramatically disproportionate to the economic value of the transaction. In these circumstances, the cost of insurance is necessarily increased because it is difficult to price such broad and unrelated risks.

The *third* alternative for commercial counterparties fearing liability from their transactions with publicly traded U.S. companies is to shift their business away from publicly traded U.S. companies altogether. This alternative would reduce the profitability and competitiveness of publicly traded U.S. companies. For example, if a producer of a component who could sell to either a U.S. or a foreign manufacturer chooses to avoid Section 10(b) participant liability risk by choosing the foreign manufacturer, the foreign manufacturer will gain a competitive advantage over the U.S. manufacturer in selling the finished product back into the United States. Even if they do not take their business overseas, vendors might forego otherwise efficient transactions because the litigation risk is too great in relation to the small size of the contract or the contract too likely to be deemed material to the issuer.

Under all three of these scenarios, adoption of Petitioner's theory would increase the cost of doing business with publicly traded U.S. companies. These costs in turn increase the cost of *being* a publicly traded U.S. company. Service providers will charge more for their services; margins will be lower; and business will be lost. In short, the economic effect of turning commercial counterparties into auditors or insurers of a publicly traded U.S. company's securities compliance would be to decrease the incentive to remain or list on a U.S. public exchange in the first place.

### B. Increasing the Cost of Doing Business with Publicly Traded U.S. Companies Encourages Flight to Foreign Equity Markets, Which Offer Increasingly Competitive Alternatives

In a closed system, increasing the cost of listing on a U.S. public stock exchange might leave companies with little alternative but to list there anyway and absorb the increased cost. But the global environment for equity capital has

become increasingly competitive. As governments in Europe and Asia have liberalized and modernized their capital markets, foreign markets are becoming robust alternatives to public exchanges based in the United States. Hong Kong, Singapore and Europe now have highly competitive stock exchanges. This new environment poses greater risk that increasing the cost of a U.S. public listing—as Petitioner's theory would entail—will encourage companies to raise capital abroad instead.

For example, U.S. capital markets are now growing at just over half the rate of foreign markets, with overall market capitalization in major foreign markets growing at ten percent a year, compared with a growth rate of six percent in the United States.

The United States is also now lagging foreign markets in the creation of new companies. In the 1990s, the number of foreign companies choosing to list on the NYSE and Nasdaq increased roughly fourfold, while European exchanges lost market share. Over the past decade, however, "the trend seems to have reversed."[7] Initial public offerings (IPOs) on U.S. exchanges have fallen from over forty percent of global capital to just seventeen percent. In 2006, twenty-three of the largest twenty-five IPOs chose to list outside the United States, meaning that only two of the top twenty-five IPOs listed on U.S. exchanges; in 2005, the number was one. Companies seeking access to U.S. investors have increasingly done so through non-U.S. capital pools; for example, U.S. institutional and retail investors have recently been increasing their holdings of non-U.S. investments by fourteen percent annually while increasing holdings of U.S. investments by only eight percent.

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[7] INTERIM REPORT, *supra* note 5, at 29.

In light of these trends, several recent major studies have concluded that the U.S. public equity market is losing competitiveness with foreign markets.[8] As countries compete with one another for pools of capital, one dimension of their relative competitiveness is litigation risk and the perception of such risk. As one study summarized, "certainly one important factor contributing to this trend is the growth of U.S. regulatory compliance costs *and liability risks* compared to other developed and respected market centers."[9]

While these concerns should not be overstated, and the $20 trillion U.S. equity capital pool remains the largest in the world, the growth of competition from foreign stock exchanges means that new litigation exposure that increases the cost of being a U.S. publicly traded company may tip the balance in a company's choice of where to list.[10] Such disincentives to public listing of equities on U.S. exchanges risk harming U.S. investors and the U.S. economy.

* * *

In sum, while it might seem at first glance that Petitioner's theory would increase enforcement in the public securities markets, imposing some increased cost on counterparties of public issuers but neutral in its effects on public issuers themselves,[11] such a view would be mistaken. Adoption of Peti-

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[8] *See id.*; MICHAEL R. BLOOMBERG & CHARLES E. SCHUMER, SUSTAINING NEW YORK'S AND THE U.S.' GLOBAL FINANCIAL SERVICES LEADERSHIP ii, 5, 12, 43-54 (2006), *available at* http://www.tinyurl.com/ 2fhyuf.

[9] INTERIM REPORT, *supra* note 5, at x (emphasis added).

[10] *See* BLOOMBERG & SCHUMER, *supra* note 8, at 16-17 (noting that "legal environment" and "regulatory balance" are the key factors after workforce quality in determining a financial center's competitiveness).

[11] Many counterparties on whom Petitioner's theory would impose new liability are in any event, as here, publicly traded companies, so that the costs would be borne by public investors either way.

tioner's novel private liability theory would impose increased costs on publicly traded companies and thus would encourage shifts at the margin to foreign (and private) alternatives. The net effect would be perversely to reduce the scope of coverage of U.S. securities laws rather than to improve their enforcement, risking harm to U.S. investors and the U.S. economy.

## II. CREATION OF ANY NEW PRIVATE SECTION 10(b) "PARTICIPANT" LIABILITY SHOULD BE LEFT TO CONGRESS

As this Court recently stated, "it is the federal lawmaker's prerogative . . . to allow, disallow, or shape the contours of . . . § 10(b) private actions." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2512 (2007). Private liability under the securities laws is "'an area that demands certainty and predictability,'" *Central Bank*, 511 U.S. at 188 (quoting *Pinter v. Dahl*, 486 U.S. 622, 652 (1988)), and clear statements by Congress serve these important values better than judicial creation of any new "complex, sinuous line separating securities-permitted from securities-forbidden conduct," *Credit Suisse Sec. (USA) LLC v. Billing*, 127 S. Ct. 2383, 2397 (2007).

It is especially appropriate to leave undisturbed Congress's decision not to create new private Section 10(b) liability for commercial participants in transactions with publicly traded companies, for three reasons:

*First*, as this Court noted in *Central Bank*, Congress knows how to impose aiding-and-abetting liability when it wishes to. Because Congress pointedly declined to provide for private aiding-and-abetting liability in the wake of *Central Bank*, judicial implication of such a claim here would be inappropriate. Judicial creation of a new private right of action under the label of "participant" scheme liability would be similarly inappropriate, for Congress has provided for "participant"

liability in several narrowly defined circumstances in the securities laws while pointedly omitting it from Section 10(b).

*Second*, Congress's institutional fact-finding capacity makes it better suited than the courts to weigh the complex economic tradeoffs involved in extending private Section 10(b) liability to remote actors who are merely commercial counterparties. *Third*, securities fraud is policed by various mechanisms other than private lawsuits under Section 10(b) that obviate the need for any judicial implication of new civil remedies pending any future congressional action.

### A. By Providing for Specific "Participant" Liability in Other Securities Laws But Not in Section 10(b), Congress Has Precluded Implied Section 10(b) Participant Liability

The text and structure of the federal securities laws resist judicial implication of a private cause of action for "participation" in a commercial transaction that later results in securities fraud by a public company. Congress in the 1930s was well aware of the concept of participant liability and employed it selectively in parts of the securities laws while contemporaneously omitting it from Section 10(b). Where Congress has expressly provided for something in one provision of the securities laws and omitted it in another, that omission generally is considered intentional. *See, e.g., Touche Ross & Co. v. Redington*, 442 U.S. 560, 571-72 (1982).

Before the enactment of federal securities laws in the 1930s, state "blue sky" laws recognized narrow variants of participant liability. Section 16 of the Model Uniform Sale of Securities Act, for example, authorized suit against any "director, officer, or agent" of a seller who "personally participated in or aided in any way" a fraudulent security sale.[12]

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[12] *See* Douglas E. Abrams, *The Scope of Liability under Section 12 of the Securities Act of 1933: 'Participation' and Pertinent Legislative Materials*, 15 FORDHAM URB. L.J. 877, 926 (1987). By the time that the

Section 15 of the Uniform Act also authorized injunctive relief against any "person or persons . . . in any way participating in . . . fraudulent practices or acting in violation" of the Act.[13]

Against this state-law backdrop, Congress authorized several specific, narrow versions of participant liability in both the 1933 Act and the 1934 Act. For example, the 1933 Act allows liability against an underwriter involved with a security for which a false registration is issued, *see* 15 U.S.C. § 77k(a)(4), and defines the term "underwriter" to include anyone who "participates or has a direct or indirect participation" in the distribution of a security, *id.* § 77b(a)(11). Similarly, Section 9 of the 1934 Act imposes liability upon "[a]ny person who willfully participates in any act or omission" that violates that section, which prohibits certain types of market manipulation. 15 U.S.C. § 78i(e). Various other provisions of the securities laws also impose liability for participation in certain specific and narrowly defined circumstances.[14]

By contrast, there is nothing in Section 10(b) that provides for participant liability. The section does not impose liability upon "participants" in underlying commercial transactions or other activities remote from the securities market. Instead, Section 10(b) makes it unlawful to "use or employ" any deceptive or manipulative device "in connection with" the purchase or sale of a security. 15 U.S.C. § 78j(b). As this Court has recognized, these elements require that the deceptive or manipulative device "coincide" with the purchase or

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Exchange Act was enacted in 1934, at least twelve states and Hawaii had adopted such participant liability. *See id.* at 926-27.

[13] By early 1933, this provision had been adopted verbatim by at least three states and Hawaii. *See id.* at 926 n.292.

[14] *See id.* at 932-34 (Trust Indenture Act); *id.* at 934-36 (Investment Company Act); *id.* at 936-37 (Investment Advisers Act); *id.* at 937-40 (Section 11 of the 1933 Act).

sale of securities. *SEC v. Zandford*, 535 U.S. 813, 822 (2002). Participation that merely facilitates fraudulent statements by another party concerning that party's securities at some point in the future cannot fit this legislative text or structure.

Where Congress has so carefully picked and chosen its spots in the securities law to impose narrow and carefully specified participant liability, judicial implication of newly expanded participant liability Congress has not chosen would be inappropriate. This Court recognized as much in *Pinter v. Dahl*, 486 U.S. 622 (1988), where it rejected the petitioner's contention that Section 12 of the 1933 Act imposed liability on any individual whose participation in the sale of securities was a substantial factor in causing the fraudulent sale to occur. The Court observed that Congress was aware of collateral participation concepts but had not chosen to implement them in Section 12. *See id.* at 650-51. *Pinter* thus supports the idea that it is only the participants specified in the statute that are covered.

Here, too, it should not be assumed that Congress simply forgot to mention in Section 10(b) that it had intended to permit a broad private cause of action for participant liability. Because Congress included narrowly defined participant liability in Section 9, an adjacent statutory provision, it is more plausibly concluded that Congress considered and rejected such liability under Section 10(b).

### B. Congress Is Better Suited than the Courts to Weigh the Costs and Benefits of Creating Section 10(b) "Participant" Liability

Whether Petitioner's proposed private right of action will, as argued above, invite wasteful strategic litigation, increase the cost of doing business with publicly traded companies and endanger the competitiveness of U.S. public equity capital markets are quintessential policy questions best suited for

careful fact-finding and systematic review. So is the question whether any possible marginal gains to deterrence could justify such costs. Such tasks are best assigned to Congress, whose broad oversight of the national economy allows it to assess the facts and make the relevant tradeoffs.

### C. Existing Regulatory Mechanisms Established and Enhanced Periodically By Congress Make Implication of Expansive Private "Participant" Liability under Section 10(b) Unnecessary

Congress has provided an extensive regulatory system that obviates the need for judicially created "participant" scheme liability such as Petitioner seeks here. That structure has an array of protections beyond private lawsuits, including administrative enforcement by the SEC, criminal enforcement by the Department of Justice, and self-regulation by the SROs. Congress has regularly supplemented these regulatory powers when needed, and can specify new forms of participant liability if it sees fit in the future.

For example, federal criminal prosecution of securities law violations has increased markedly since the 2002 creation of the Corporate Fraud Task Force within the Department of Justice. Moreover, the SEC's administrative enforcement power has been increased by recent legislation, most notably by the FAIR Funds Act's establishment of a fund through which over $8 billion has been collected for the purpose of disgorgement to investors and payment of civil penalties. *See* 15 U.S.C. § 7246. Regulation may be extended where appropriate beyond immediate securities market actors; as noted above, the PSLRA conferred upon the SEC the authority to prosecute aiding and abetting of Section 10(b) violations.

The authorities exercised by private SROs are another component of the complex, overlapping mosaic of protection that investors enjoy under the federal securities laws. The concept of self-regulation was, from its inception, a corner-

stone of federal oversight of the securities and futures industries. The Securities Exchange Act of 1934 authorizes SROs to promulgate and enforce rules governing their membership and the conduct of members, member organizations and their employees, 15 U.S.C. §§ 78f(b)(1)-(9), 78s(g). SROs are also required "to remove impediments to and perfect the mechanism of a free and open market . . . and, in general, to protect investors and the public interest." 15 U.S.C. § 78f(b)(5). Congress's delegation of authority to SROs creates an overlapping system of market protection that uses valuable, expert, front-line oversight by industry-dedicated professionals to supplement regulatory enforcement and help meet the challenges posed by the size, complexity and pace of the public equities markets.

Other advantages of self-regulatory authority are the flexibility to address new unfair or manipulative trading practices and the ability to set standards that exceed those imposed by the SEC—for example, to preclude conduct detrimental to the market and contrary to equitable principles of trade.[15]

SROs such as Nasdaq and the NYSE provide several forms of self-regulation. They regulate the conduct of their members through an independent non-governmental body, the Financial Industry Regulatory Authority (FINRA), formed in 2007 through the consolidation of the National Association of Securities Dealers (NASD) and certain regulatory functions of the NYSE, including its enforcement arm. In addition, the SROs themselves, with the approval and oversight of the SEC, set standards and ascertain eligibility for companies listing on their exchanges. While they do not duplicate the audit function, they regularly review their listed companies' compliance with financial and governance listing standards. This monitoring function also enables the enforcement of the

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[15] *See generally* S. REP. NO. 73-1455 (1934); H.R. DOC. NO. 73-1383, 2d Sess. (1934).

exchanges' disclosure obligations and early detection of issues that might give rise to a public interest concern.

SROs wield enforcement authority including the ability to halt trading and the ultimate sanction of delisting public companies from their exchanges. Delisting may occur for several reasons, including the failure to maintain the quantitative standards required by rule, timely file periodic reports, or meet required corporate governance standards such as obtaining requisite shareholder approvals or maintaining audit committee independence. An issuer may also be delisted when the exchange determines it has acted contrary to the public interest, even if the issuer meets all enumerated criteria for listing.

Congressional support for the SRO system is evident in its periodic reexamination of SRO powers, reaffirmation of the system, and expansion of SRO authority when needed.[16] For example, the Sarbanes-Oxley Act of 2002 mandated stricter audit committee corporate governance listing standards. Congress has determined these expansions of authority to be appropriate because SROs, like the SEC, have a comparative advantage over private securities plaintiffs in expertise and systematic knowledge of the markets.

This complex and overlapping set of protections, subject to periodic congressional review and enhancement, needs no supplement from new and unbounded private rights of action for "participant" liability.

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[16] *See, e.g.*, U.S. SEC. EXCH. COMM'N REPORT OF SPECIAL STUDY OF SECURITIES MARKETS, H.R. DOC. NO. 88-95 1st Sess. (1963); U.S. SEC. EXCH. COMM'N, MARKET 2000: AN EXAMINATION OF CURRENT EQUITY MARKET DEVELOPMENTS, Division of Market Regulation, U.S. Securities and Exchange Commission (1994).

## CONCLUSION

The decision below should be affirmed.

Respectfully submitted,

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